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FISCAL IMPACT STATEMENT

LS 6845
BILL NUMBER: HB 1380

NOTE PREPARED: Jan 13, 2006
BILL AMENDED:

SUBJECT: Various Economic Development Matters.

FIRST AUTHOR: Rep. Smith J
FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: *Small Business Impact of Legislation:* The bill establishes a process by which the small business coordinator of each state agency may submit comments about the impact of a proposed bill to the Office of Management and Budget (OMB). It requires, after review by the OMB, the comments to be posted to the General Assembly's web site by the Legislative Services Agency.

Regional/Local Venture Capital Funds: The bill authorizes the Board for Depositories to invest money in the Public Deposit Insurance Fund (PDIF) that exceeds the PDIF's cash working balance in guarantees of loans made from regional and local venture capital funds. The bill authorizes counties, cities, and towns that receive county economic development income taxes (CEDIT) to: (1) establish local venture capital funds; and (2) establish regional venture capital funds by pooling taxes payable to the participating units. It provides that a regional venture capital fund shall be administered by a governing board. It also authorizes the governing board to make grants or loans from the fund to public or private entities for economic development purposes.

The bill provides that the Indiana Economic Development Corporation (IEDC) may grant an Economic Development for a Growing Economy (EDGE) Tax Credit for the creation or retention of jobs if an applicant meets at least one of certain specified conditions. (Current law requires an applicant to meet all of the conditions.) It revises provisions concerning average wages with respect to: (1) eligibility for an EDGE credit to retain existing jobs; and (2) the amount of an EDGE credit to create jobs. It also deletes the requirement that an applicant for an EDGE credit for the retention of jobs employ at least 75 persons. The bill increases the $5,000,000 per year cap on the amount of EDGE credits that may be granted to retain existing jobs during each state fiscal year to $10,000,000 per year for FY 2006 and FY 2007.

High Growth Tax Credit: The bill provides that the IEDC may award an Adjusted Gross Income Tax credit to a business that: (1) has been actively engaged in business in Indiana for at least two years; (2) has Adjusted Gross Income (AGI) growth of 20% for two consecutive years; (3) has AGI between $1,000,000 and $10,000,000 in the first year in which the business has 20% growth; and (4) employs or contracts with at least five individuals. It also allows a county, city, or town to use County Economic Development Income Tax revenue to provide a grant to a business that meets the eligibility criteria for the credit.

Effective Date: April 1, 2006; July 1, 2006.

Explanation of State Expenditures: *Small Business Impact of Legislation:* The bill is expected to increase administrative costs for state agencies to provide small business coordinators, for the OMB to review prepared comments, and for LSA to post information to the General Assembly's website. Under the bill, the Governor must designate an employee in each state agency to review and comment on proposed legislation affecting small business. The OMB must review and make amendments to the comments and forward the amended comments to LSA for posting on the General Assembly's website. The funds and resources required to perform these administrative tasks could be supplied through a variety of sources, including the following: (1) existing staff and resources not currently being used to capacity; (2) existing staff and resources currently being used in another program; (3) authorized, but vacant, staff positions, including those positions that would need to be reclassified; (4) funds that, otherwise, would be reverted; or (5) new appropriations. Ultimately, the cost of providing small business coordinators and comments about legislation affecting small businesses will depend on the administrative actions of state agencies, the OMB, and LSA.

High Growth Tax Credit: The Department of State Revenue (DOR) will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the new tax credit. The DOR's current level of resources should be sufficient to implement these changes.

The IEDC must administer the High Growth Tax Credit. The IEDC's current level of resources should be sufficient to fulfill the administrative tasks relating to the tax credit. The December 5, 2005, state staffing table indicates that the IEDC had 39 vacant, full-time positions, including one regional office position.

Regional/Local Venture Capital Funds: The bill authorizes counties and municipalities to place CEDIT revenue in a Venture Capital Fund (VCF) for: (1) economic development; (2) technology development; and (3) industrial, commercial, and employment growth. Any VCF established by a county or municipality would be subject to an annual audit by the State Board of Accounts (SBA). The audit of a VCF likely could occur at the time the SBA audits other funds of a county or municipality. SBA personnel would likely see an increase in administrative time to complete the audit of any new VCF established under the bill. However, the VCF is required to cover the cost of the audit.

Additionally, terms for establishment of either regional or local VCFs and a governing board would have to be submitted to the IEDC for approval before contributions to the VCF could begin. The provision would likely increase the administrative time of the IEDC to approve VCF multiple-unit agreements.

The bill also authorizes the State Board for Depositories to invest money in the Public Deposit Insurance Fund in excess of the cash working balance in the Fund in guarantees of loans made from a VCF.

Background: The PDIF was created in 1937 to insure the deposits of public monies in Indiana financial institutions. PDIF is administered by the Indiana Board for Depositories. The purpose of the Board is to insure the safekeeping and prompt payment of all public funds deposited in any approved depository. The PDIF is funded by assessments payable by every depository that has public funds. The expenses of the Board are paid from the PDIF. The FY 2005 ending balance in the PDIF totaled approximately $302.5 M.

Explanation of State Revenues: *High Growth Tax Credit:* The bill establishes a tax credit for certain businesses that have experienced at least 20% annual growth in adjusted gross income (AGI) during the prior two years. The credit is equal to 50% of a qualified business's tax liability under the AGI Tax, Financial Institutions Tax, or Insurance Premiums Tax. The amount of credits that businesses could potentially claim beginning in tax year 2007 is indeterminable and would depend upon credit certification decisions by the IEDC. The net revenue impact depends on the extent that tax collections on new employees or additional taxable activities attributable to the businesses receiving credits deviates from the credit amounts they claim. However, if the employment and wage growth and business expansion would have occurred in the absence of the credit, the net impact would be the total credits claimed by these businesses. Any resultant fiscal impact due to the bill could commence in FY 2007.

EDGE Credit Program: The bill makes the following changes that could potentially result in a fiscal impact.

(1) The bill increases the annual limit on EDGE credits for job retention projects applicable in FY 2006 and FY 2007 from $5 M to $10 M. Under current statute unchanged by the bill, the annual credit limit no longer applies beginning in FY 2008. The potential amount of additional credits that might be awarded by the IEDC Board in FY 2006 and FY 2007 due to the bill is indeterminable, but could not exceed $5 M each year. EDGE credits for job retention were awarded for the first time in 2003. The EDGE Board awarded $2.0 M in new credits for two projects in 2003, and $3.75 M in new credits for four projects in 2004. (Note: Under current statute, the IEDC Board awards EDGE credits.) As of July 2005, the IEDC Board had awarded $250,000 in new EDGE credits for one job retention project.

(2) The bill changes current statute requiring EDGE credit applicants to meet a number of project-related requirements, to a requirement that the applicants only meet one of these project-related requirements. Before the IEDC Board may award EDGE credits, current statute requires that the Board determine that: (1) job creation projects meet certain conditions relating to the number of jobs to be created and the economic and fiscal impact of the project; and (2) job retention projects meet specified average wage, employment, and other conditions.

(3) The bill eliminates the minimum employment requirement under current statute for EDGE credits to be awarded for job retention projects. The minimum employment requirement is currently 75 employees.

(4) The bill changes the current average compensation standard for approval of EDGE credits for job retention projects, and for determining the amount of EDGE credits for job creation projects. Currently, the average wage standard is linked to the average compensation paid to employees working in the same industry sector in the county where the business's project is located, or in the state if no other business in that industry operates in the county. If no other business in that industry sector operates in the state, the average compensation must be at least 200% of the federal minimum wage for job retention projects, and must exceed the county average for all employees for job creation projects. The bill provides that the business meet at least one of these standards.

The changes described in (2) to (4) above would apply to EDGE credit applications filed after March 31, 2006. These changes could facilitate approvals of EDGE credits for projects that don't meet the above-described conditions and, therefore, would not qualify for EDGE credits under current statute. The precise fiscal impact of this change is, however, indeterminable.

Background: High Growth Tax Credit: The tax credit is equal to 50% of the business's tax liability after application of other credits and deductions the business takes for the taxable year. To be eligible for the tax credit a taxpayer must: (1) have been engaged in business in Indiana for at least 2 years; (2) have had at least 20% growth in AGI during each of the two taxable years preceding the current taxable year; (3) have generated between $1 M and $10 M in AGI during the first taxable year the business experienced at least 20% growth in AGI; and (4) employ at least five people. The bill provides that a taxpayer must apply to the IEDC for approval of the credit, and that the IEDC may not approve credits for taxable years before tax year 2007. If the IEDC approves credits for tax year 2007, taxpayers could potentially adjust quarterly estimated payments with the fiscal impact potentially occurring in FY 2007.

Due to the time frame involved in determining eligibility for the tax credit and data limitations, taxpayer simulations were performed utilizing data from corporate and financial institutions taxpayers for tax years 2001, 2002, and 2003; and for sole proprietorships for tax years 2001 and 2002. Entity-level AGI data is unavailable that would allow simulations with respect to S-Corporations or partnerships that may be eligible for this credit. The simulation results using available data were varied, with the impact of the credit lagging general economic conditions. As a result, the extent that taxpayers might qualify for the credit in upcoming years is uncertain. The taxpayer simulations generated the following results: (1) credit qualifiers totaled 14 for 2003 taxpayers; 23 for 2002 taxpayers; and 28 for 2001 taxpayers; and (2) computed credits totaled $1.5 M for 2003 taxpayers; $5.1 M for 2002 taxpayers; and $3.3 M for 2001 taxpayers. The table below presents examples of calculated credits for a business with just over $1 M in AGI and a business with just under $10 M in AGI.

Example 1		
AGI	$1,000,001	
Filer Status	Individual	Corporate
AGI Tax	$34,000	$85,000
Credit	$17,000	$42,500
Example 2		
AGI	$9,999,999	
Filer Status	Individual	Corporate
AGI Tax	$340,000	$850,000
Credit	$170,000	$425,000

The tax credit may be claimed by individuals, corporations, and pass through entities. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity. Revenue from the corporate AGI Tax, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. The revenue from the individual AGI Tax is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

<u>EDGE Credit Program:</u> Under current statute, businesses that (1) create new investment and jobs in Indiana or (2) undertake projects to retain existing jobs in Indiana are eligible for EDGE credits. As it applies to investment that creates new jobs, the EDGE Program is designed to provide a revenue-neutral incentive for businesses to create new investment and jobs in Indiana. Such businesses receive credits equal to the individual income taxes withheld for employees filling the newly created positions. Since revenue from these employees would not have been collected in the absence of the new development, the state does not incur a net loss by redistributing the incremental income tax revenue as tax credits to businesses. For job retention projects, no new revenue would be realized since no new jobs would be created. As a result, EDGE credits for job retention are paid from existing revenues, resulting in a net loss to the state equal to the amount of EDGE credits granted to businesses for job retention. However, if a business were to select a more profitable alternative project site and move out of Indiana, there could be an even greater loss of revenue from the reduction in individual (employee's) and corporate taxes.

EDGE credits are awarded for a duration of up to 10 years during which the credit amounts may be used. EDGE credits may be taken against a taxpayer's AGI Tax, Insurance Premiums Tax, or Financial Institutions Tax liabilities. The duration of the credit may not exceed ten taxable years. Revenue from the AGI Tax on corporations, the Insurance Premiums Tax, and the Financial Institutions Tax is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of the revenue is deposited in the Property Tax Replacement Fund.

<u>**Explanation of Local Expenditures:**</u> *Regional/Local Venture Capital Funds:* Under the bill, counties or municipalities with CEDIT revenue are authorized to use amounts of their CEDIT revenue for venture capital projects. Local authorities are required to establish either a local or regional venture capital fund to retain CEDIT revenue distributed to a local taxing unit. Additionally, a VCF may receive proceeds of either public or private grants. Money in VCFs could be used to provide loans or grants to either a private or public entity. Grants and loans must be spent on: (1) research and development technology; (2) job training and education; (3) acquisition of property interests; (4) infrastructure improvements; (5) new buildings or structures; (6) rehabilitation, renovation, or enlargement of buildings or structures; (7) machinery, equipment, and furnishings; or (8) funding small business development.

VCFs must be administered by a governing board of an unspecified number of individuals. A participating unit in a venture capital project must have at least one member on the governing board. Expenses to operate a VCF are to be paid from money in the VCF, including expense for audits conducted by the State Board of Accounts.

Business Grants with CEDIT Revenue: The bill authorizes counties and municipalities that receive CEDIT revenue to use these funds to provide grants to businesses that meet the eligibility criteria for the high growth tax credit proposed in this bill. (See *Explanation of State Revenues* for a discussion of the eligibility criteria for the tax credit.) The bill limits grants to $25,000 per eligible business.

<u>**Explanation of Local Revenues:**</u> *CEDIT Revenue:* The potential impact of CEDIT revenue being utilized in a VCF or for business grants would depend on local action The bill authorizes counties and municipalities to: (1) place CEDIT revenue in a VCF for economic development; technology development; and industrial, commercial, and employment growth; or (2) use CEDIT revenue for grants to certain businesses. (See *Explanation of Local Expenditures* for discussion of VCF programs and business grants to businesses meeting the High Growth Tax Credit criteria.) <u>The bill does not authorize an increase in a county's CEDIT rate.</u>

Counties and municipalities that expend CEDIT revenue for these new purposes would have less of their CEDIT revenue available for other uses allowed under current law.

Background: Under current law, CEDIT revenue may be used for several purposes including: (1) county, city, or town economic or capital development projects; (2) capital improvement plans; (3) funding for increased homestead credit due to the reduction of state and county inventory taxes; or (4) maintenance of courthouse facilities. There are currently 72 counties that have adopted CEDIT. CY 2006 certified distributions for all adopting counties totaled $236.5 M. Under current law, CEDIT rates may be set at 0.1%, 0.2%, 0.25%, 0.3%, 0.35%, 0.4%, 0.45%, and 0.5%.

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation; Legislative Services Agency; Office of Management and Budget; State Board of Accounts; State Board for Depositories.

Local Agencies Affected: Counties and municipalities receiving CEDIT revenue.

Information Sources: Gretchen White, IEDC, (317) 234-3997. OFMA Income Tax Databases, 1998-2003. Indiana Department of Commerce, *2003 EDGE for Retention Annual Report*, March 31, 2004; *2004 EDGE for Retention Annual Report*, March 31, 2005. *Indiana Handbook of Taxes, Revenues, and Appropriations, FY 2005*; Treasurer's *FY 2005 Annual Report*.

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